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December 20, 2005

Luly E. Massaro, Commission Clerk
Rhode Island Public Utilities Commission
89 Jefferson Boulevard
Warwick, RI 02888

Re: Docket No. 3692 – Verizon RI Proposed Alternative Form of Regulation Plan


Dear Ms. Massaro:

Enclosed for filing are the original and nine copies of the Post-Hearing Brief of Verizon Rhode Island.

Please be advised that portions of the brief are proprietary and confidential, and those proprietary portions are being provided only to the Commission, the Division, and the Attorney General in accordance with the terms of the Protective Agreements between Verizon RI and those parties.

As always, please call me with any questions. Thank you for your attention to this matter.

Sincerely,

Alexander W. Moore 

Alexander W. Moore

Enclosures

cc: Service List

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

PUBLIC UTILITIES COMMISSION

Investigation into a Successor Alternative
Regulation Plan for Verizon New England Inc.
d/b/a Verizon Rhode Island

Docket No. 3692

POST-HEARING BRIEF OF VERIZON RHODE ISLAND

INTRODUCTION

Verizon New England Inc., d/b/a Verizon Rhode Island (“Verizon RI”), submits this brief in support of its proposed Successor Alternative Regulation Plan (“the Plan”). The terms of the Plan are fair, reasonable, and provide the most appropriate form of regulation of Verizon RI’s intrastate operations in light of the fierce competition in the Rhode Island market. According to the undisputed evidence, Rhode Island boasts the single most competitive telecommunications local exchange market of any state in the nation. In particular, the substantial and largely undisputed evidence in the record of this proceeding demonstrates that competition in the residential local exchange market is now sufficiently robust to constrain Verizon RI from profitably charging rates above competitive levels for a sustained period of time. Accordingly, and consistent with its precedent, the Commission should approve the Plan as submitted and allow Verizon RI’s rates for both business and residential services to respond to the market, just as Verizon RI’s rates for business services do now and just as all of the rates charged by Verizon RI’s competitors do. More generally, in the absence of market power, the Commission need not and should not regulate Verizon RI’s rates and operations any differently than it regulates those

of other telecom carriers, and it should eliminate its current, asymmetric regulation of reporting requirements and Lifeline subsidy levels, again as provided in the Plan.

BACKGROUND

The Commission has long recognized the importance of developing a competitive market for telecommunications services in Rhode Island. Even prior to the passage of the Telecommunications Act of 1996, the Commission had determined that “a competitive intrastate telecommunications market is in the best interest of the citizens of Rhode Island.” *See Comprehensive Review of Intrastate Telecommunications Competition*, Docket No. 2252 (June 30, 1995), at 3, 4. The Commission had already taken a significant step in fostering the growth of market-based incentives and competition in Rhode Island when it replaced traditional rate-of-return for Verizon RI and permitted the company to share in profits generated through efficiency and cost reductions. *See* Commission Order No. 13061. The Commission has thereafter gradually reduced its control over Verizon RI’s rates as the market has matured and become better able to discipline Verizon RI’s prices without the need for government intervention. *See, e.g.,* Order No. 15020 (approving Price Regulation Plan in 1996) and Order No. 16390 (approving Price Regulation Successor Plan in 2000).

Most recently, the Commission approved Verizon RI’s Alternative Regulation Plan (“ARP”) in early 2003. *See* Order No. 17417 (issued March 11, 2003). Among other things, the ARP granted Verizon RI the flexibility to set its own rates for business services in response to changes in the market. The ARP also allowed Verizon RI some flexibility with respect to basic residential rates, allowing the company to set its rates but imposing a \$1 annual cap on any price increases.

In approving the ARP, the Commission reiterated its decade-long policy of encouraging competition and allowing Verizon RI greater pricing flexibility as competition expands:

We hope that in time, the need for price ceilings and price floors will diminish as the competitive local telephone exchange market fully develops. The more competitive this market becomes, the less need there is for regulatory oversight so that at some point, this Commission would only “intervene and interfere” with the natural workings of the competitive market only cautiously and with great circumspection.

Order No. 17417, at 59-60. At a more practical level, the Commission also established an analytic framework to assess the relevant economic evidence before it and determine whether to grant Verizon RI flexibility to price with the market. As set forth by the Commission, the key issue is:

[whether] there is sufficient competition to restrain VZ-RI from exercising market power. Market power is the ability to profitably raise prices above the competitive level for a sustained period of time. In order to determine if a company can exercise market power, market share, supply elasticity, and demand elasticity for the product is examined.

Id., at 45 (footnotes omitted.) In assessing these three factors in light of the evidence of competition at the time, the Commission relied on the Division’s testimony that demand elasticity – meaning in this case the willingness and ability of telephone customers to change carriers – was relatively low. *See* Order 17417 at 47. The Commission placed greater weight on market share, however, both in its own right and as an indicator of supply elasticity – here meaning the ability of Verizon RI’s competitors to absorb additional business in response to a hypothetical supra-competitive price increase by the company. The Commission found that where Verizon RI’s share of the market is below 70%, market forces are sufficiently powerful to discipline Verizon RI’s rates without the assistance of government price regulation. As the Commission stated it:

In the Rhode Island business market, the VZ-RI market share is below 70 percent. As a result, we find there is sufficient competition to eliminate the need for any price ceilings on VZ-RI's retail business services.

Due to the more than 70 percent market share of VZ-RI in the Rhode Island residential market, however, the Commission finds there is a continuing need for price ceilings on VZ-RI's retail residential services.

Id. at 49. Accordingly, the Commission allowed Verizon RI's rates for business services to respond to the market. Although the Commission allowed more limited flexibility with respect to Verizon RI's rates for basic residential services, approving the \$1 annual cap, it also expressed hope for eliminating that ceiling in the future, stating that, "[A]s the CLEC market share grows in the residential market, we expect the need for price ceilings to diminish." *Id.* at 51.

Contrary to the dire warnings of some of Verizon RI's competitors at the time, the additional flexibility granted Verizon RI with respect to its business rates has had no anti-competitive effect. In fact, competition in both the business and residential markets has continued to expand at a rapid pace since the Commission's decision, and Verizon RI's competitors now control more than BEGIN PROPRIETARY *** *** END PROPRIETARY of the business market and nearly BEGIN PROPRIETARY *** *** END PROPRIETARY of the residential market, as measured by traditional, land-based access lines. *See Kenney Direct Testimony*, at 3, and Attachment 1 thereto.

ARGUMENT

The Terms of the Plan Are Just and Reasonable And Reflect The Fully Competitive Local Exchange Market In Rhode Island. The Commission Should Approve The Plan As Submitted.

The Successor Alternative Regulation Plan now before the Commission proposes limited changes in the way the Commission would regulate Verizon RI's intrastate operations. The Plan thus represents another evolutionary step in the development of a fully competitive local

exchange market in Rhode Island and in the Commission's continuing policy of reducing the extent of its regulation of Verizon RI's operations as competition in the market expands. The Plan recognizes the robust level of competition in the local exchange market today in a number of ways. First, the Plan would continue the Commission's successful policy of allowing Verizon RI the flexibility to set its own rates for business services in light of changing conditions in the market. Second, the Plan would extend that flexibility to Verizon RI rates for residential services as well, in light of the rapid expansion of competition in that sector of the market over the last three years. Third, as a further consequence of the growth and maturation of competition in the states, the Plan would eliminate current, asymmetric regulations imposed on Verizon RI in other areas. Specifically, the Plan would gradually reduce the level of Verizon RI's subsidy of unlimited basic exchange service under the Lifeline program by \$1 a year over the next two years, to bring the total monthly subsidy to \$7, an amount previously approved by the Division and the Commission and on par with the subsidy provided by Cox. The Plan would likewise eliminate archaic and burdensome reporting requirements that have historically been imposed on Verizon RI but not on other telephone carriers. In essence, because Verizon RI no longer has market power, the Plan proposes that the Commission move toward regulating Verizon RI's rates and operations in the same manner and to the same degree it regulates all other wireline carriers in the state.¹ Verizon RI addresses below the key issues addressed in the Plan or raised at hearing.

¹ Even under the terms of the Plan, Verizon RI will be subject to price floor requirements that no other telecom carrier must meet. Thus, the Plan represents progress toward, but not achievement of, complete symmetry in regulatory oversight for all carriers.

- I. The Commission should extend to Verizon RI's rates for residential services the same pricing flexibility already afforded to Verizon RI's business rates.

The Plan provides for continuation of the policy established in the current plan allowing Verizon RI's rates for business services to be set by the market, rather than governmental regulation. No party has questioned the efficacy or appropriateness of that policy in this proceeding nor asked the Commission to revisit its 2003 decision granting Verizon RI such flexibility. The proposed Plan would merely extend that policy to Verizon RI's rates for residential services. This incremental change is well-supported by the record before the Commission.

- A. Competition in the residential local exchange market is sufficient to discipline Verizon RI's rates for residential services.

Verizon RI has submitted overwhelming evidence – for the most part undisputed – that competition in the residential market is both fierce and widespread, and that Verizon RI faces significant and rapidly growing competition from traditional CLECs and, increasingly, from wireless carriers and providers of voice over internet protocol (“VoIP”) service as well. As noted above, the FCC has found that Rhode Island is the single most competitive local exchange market in the nation, measured in terms of land-based access lines. *See* Kenney Direct Testimony, at 4-5 and Attachment 2. CLECs, led by Cox Telecom, the telephone arm of CATV giant Cox Communications, control nearly BEGIN PROPRIETARY *** *** END PROPRIETARY of the residential market today. *Id.* at 3. Cox, in particular, is now an Eligible Telecommunications Carrier under the Universal Service provisions of the 1996 Telecommunications Act and offers, and is required to offer, unlimited basic exchange service to every residential customer in the state. *See* Transcript (“Tr.”) 12/07/05, at 18-19. To shift from

a static snapshot of the market to a dynamic point of view, CLECs' share of the residential market, again measured solely in terms of land-based access lines, has BEGIN PROPRIETARY *** END PROPRIETARY since February of 2002. Kenney Direct Testimony, at 3.

The indisputable evidence also shows that the wireless industry has continued to grow by leaps and bounds and is now a formidable constraining force in the Rhode Island residential market. Since 2000, the number of wireless telephone subscribers in Rhode Island has almost doubled and stood at 607,000 in December of 2004. Kenney Direct Testimony at 9. In approving Verizon RI's current Alternative Regulation Plan in 2003, the Commission had expressed its concern that, "[w]ireless telephone service is not as reliable, universal or affordable as landline telephone service." Order No. 17417 at 46. Based on this concern, the Commission found that the relevant product market for its economic analysis of Verizon RI's market power was limited to landline telephone service and, in essence, that that market was dominated by a duopoly comprised of Verizon RI and Cox. *See id.* at 46 and 48. The continued explosion of wireless service should put the Commission's former concern to rest. As pointed out at hearing, the number of wireless subscribers in Rhode Island (607,000) is one and one-half times larger than the total number of residential purchasers of electricity in the state (approximately 425,000) and is *twice* as large as the number of subscribers to cable television in the state.² Mr. Kenney pointed out at hearing that 30,000 former Verizon RI residential customers in Rhode Island may have given up their landline phones entirely in favor of wireless service, Tr. 12/06/05, at 153-154, and that even where wireless subscribers have elected to keep their old landline phone, wireless has eaten deep into Verizon RI's annual minutes of use and toll revenues. Tr. 12/06/05, at 236-237; Kenney Direct Testimony at 9. Thus, Verizon RI competes with the wireless

² See Tr. 12/07/05 at 85-86; Tr. 12/06/05, at 161, 163.

industry for our residential customers' business, and the popularity of wireless service throughout the state provides a substantial check on Verizon RI's ability to raise prices above competitive levels.³

That check is significantly reinforced by the advent and burgeoning of VoIP service. Mr. Kenney testified that VoIP providers have already made significant progress in winning over customers, that the largest VoIP provider, Skype, has 12.9 million users nationally and that another widely known provider, Vonage, recently announced it has over 1,000,000 customers across the country. Kenney Direct Testimony at 6, Tr. 12/06/05, at 149. Mr. Kenney explained that as of December of 2004, there were over 165,000 subscribers of high speed internet service in Rhode Island who can obtain VoIP service, and that there are a number of providers to choose from. Kenney Direct Testimony at 5-7. Furthermore, VoIP rates compare favorably to landline-based rates, with one VoIP provider offering unlimited calling within the U.S. and Canada for only \$19.95 per month. *Id.* at 7. Other carriers offer service, sometimes with generous usage allowances, for as little as \$12.95 a month. *See id.* and Attachment 3.

While one participant expressed concern at hearing that the actual number of VoIP subscribers in Rhode Island may be low, it is the mere availability of a VoIP option that poses the market threat to Verizon RI and thus constrains its prices. As Mr. Vasington explained, "[VoIP] is maybe not a substitute for [landline service] for every single customer, but I think it's a substitute for enough customers that it's a significant price disciplining force in the marketplace." Tr. 12/06/05 at 150. As Mr. Vasington also stated:

³ That Verizon RI is affiliated with Verizon Wireless does not lessen the disciplinary effect of wireless prices on Verizon RI's rates for landline service. The wireless industry itself is intensely competitive, and Verizon is not even the sole owner of Verizon Wireless. Thus, Verizon RI has no assurance that a customer who replaces landline service with wireless will choose to remain with Verizon. *See Vasington Direct Testimony at 23.*

It is important to recognize that for intermodal services, such as wireless and VoIP, to provide a competitive threat to wireline, it is not necessary that every customer consider it to be an alternative under all circumstances – it is only necessary that enough customers consider it to be an adequate alternative that it would be unprofitable in the long term for Verizon RI to charge unjust and unreasonable prices. ... [W]hat the Commission should be concerned with is the expected response of suppliers and consumers in the event that Verizon RI stopped charging just and reasonable rates, in which case it is clear that many more customers would be willing to switch to alternative services.

Vasington Direct Testimony, at 10. That VoIP and wireless service providers compete directly with Verizon RI for residential customers and thus strongly constrain Verizon RI's residential rates is beyond dispute. As the Division's expert, Mr. Weiss, testified, the data before the Commission:

demonstrate that alternative technologies (e.g. VoIP, wireless) offered by unregulated entities are resulting in *significant displacement* of regulated wireline access as means for consumers to access telecommunications networks in the state.

Weiss Direct Testimony, at 8 (emphasis added).

Finally, the uncontroverted evidence is that competition is no longer a feature of urban markets alone, but has spread throughout the state. Alternatives to Verizon RI residential service are available throughout the state in the form of landline service (from Cox), wireless and VoIP. Even with respect to landline service alone, CLECs now control a greater share of the access lines in *every* wire center in the state (but one) than they controlled in *any* wire center three years ago. Put another way, **BEGIN *** *** END PROPRIETARY** of the residential access lines in the state are served out of wire centers where Verizon RI controls less than 70% of the residential access lines.

Applying the Commission's analytic framework from Order No. 17417 to this evidence of heated and broad-based competition in the residential local exchange market demonstrates that

market forces are more than sufficient to preclude Verizon RI from profitably raising rates for its residential services above competitive levels for a sustained period of time, and thus that the Commission should allow those rates to respond to the market. As Mr. Vasington, testified, “The question here is whether competition is sufficient to prevent Verizon RI from exercising market power, and the answer is that the market is sufficiently competitive for that purpose”

Vasington Direct Testimony, at 5. No party has disputed Verizon RI’s evidence that its share of the residential market is well below the 70% threshold the Commission established in Order No. 17417.⁴ With respect to both demand elasticity and supply elasticity, Mr. Vasington explained that the rapid expansion of competitors’ share of the market over the past three years demonstrates that residential customers are and have been willing and able to leave Verizon RI for Cox, wireless and VoIP providers and that those providers are clearly willing and able to expand their output and absorb the additional business. Vasington Direct Testimony at 14-16.

Thus, all of the three factors comprising the Commission’s framework for assessing market power – Verizon RI’s low and falling market share and the market’s high supply elasticity and high demand elasticity – support a finding that the market is sufficiently competitive to discipline Verizon RI’s residential prices and preclude Verizon RI from exercising market power. The Commission should accordingly allow Verizon RI the flexibility to set its rates for residential services in response to market conditions.

- B. There is no basis in fact or law for the concerns raised by other parties regarding the Plan’s provision for market-based residential rates.

The arguments offered by the Division and others in response to Verizon RI’s proposal for market-based residential rates are not supported by the evidence before the Commission.

⁴ Indeed, as demonstrated in Verizon RI’s Response to Commission Data Request 2-3, Verizon RI’s share of the residential market remains well below 70% even if the residential access lines of MCI are counted as Verizon RI lines in anticipation of the pending merger of the companies.

Moreover, those arguments, which are addressed below, are of limited scope and do not take issue with Verizon RI's fundamental conclusion that competition in the residential local exchange market is sufficient to constrain Verizon RI from attempting to charge unjust or unreasonable rates. No witness disputed Verizon RI's data showing the rapid expansion of CLEC market share among land-based access lines over the past three years or the ease with which most residential customers can and do switch carriers. No witness disputed that VoIP and especially wireless service discipline Verizon RI's rates, and Mr. Weiss agreed that those technologies are displacing traditional land-based service. Most importantly, no witness argued that the analytic framework established by the Commission in Order No. 17417 should not apply here, and no witness offered any economic market analysis contradicting Mr. Vasington's testimony summarized above. Thus, no party has a reasoned basis for contesting Verizon RI's demonstration that the Plan is consistent with the standards and precedent previously adopted by the Commission for evaluating the competitiveness of the market and that price ceilings on Verizon RI's residential rates are no longer appropriate.

1. The rates set by a competitive market are reasonable by definition.

At hearing, the Division implied in its questioning that market forces alone may result in rates for Verizon RI's residential services that some consumers may find to be unreasonable, which the Division argued would violate the requirement of R.I.G.L. §39-2-1 that the rates of a public utility such as Verizon RI be "reasonable and just." *See*, Tr. 12/06/05 at 36, 73-75. The "reasonable and just" statutory standard is not impressionistic, however, subject to polling of consumers on the street. A finding that rates are just and reasonable must be based on some standard, such as costs or sufficient competitive pressure, allowing the Commission authority to make such a determination in light of the evidence before it. Governmental regulation designed

to ensure “reasonable” rates is only an imperfect substitute for the rates that would be set by a competitive market. Tr. 12/06/05 at 219. Thus, Mr. Vasington testified at hearing that a competitive market will, by definition, produce rates that are just and reasonable. *Id.* at 232-233. In any event, the Division’s position that the Commission must continue to regulate Verizon RI’s rates because the company remains a public utility cannot be taken too seriously, in light of the Division’s failure for many years to seek rate regulation of the other telephone carriers in the state, all of whom are public utilities as defined by R.I.G.L. §39-1-2(20). That statute does not differentiate between incumbent carriers and new entrants.

2. Competition in the Rhode Island local exchange market disciplines Verizon RI’s residential rates even for those consumers who do not obtain phone service from alternative service providers or technologies.

While not disagreeing with Verizon RI’s general conclusion that competition is sufficient to discipline its prices in most instances, the Division asserted that there may be a subset of residential customers who do not benefit from and are not protected by the current market forces. Mr. Weiss stated that “[M]any residential users do not have viable options, either economically or technically.” Weiss Surrebuttal Testimony, at 2. At hearing, Mr. Weiss clarified that the group of consumers he is concerned about does not include wireless customers, nor Cox’s 300,000 cable television subscribers nor those who have computers (and thus have access to VoIP service). Rather, his concern is for those residential consumers who just want primary, basic exchange service. Tr. 12/07/05 at 50-51. Apparently with this subset of the market in mind, Mr. Weiss asserted that it was appropriate to impose a cap on Verizon RI’s rates but not on the rates of its competitors, even in light of the extent of competition in the market, because “Verizon remains the carrier of last resort for many users of primary residential local exchange service in the state and, as such, it controls the proverbial ‘last mile’ of access for such users.”

Weiss Surrebuttal at 2. The Division's facts are wrong, and its theory supporting continued disparate regulation of Verizon RI holds no water.

First, Mr. Weiss conceded on the stand that Verizon RI is not the *only* carrier of last resort in the state because Cox, as an ETC, offers its basic unlimited residential service throughout the state and is required to provide service to any customer who requests it. Tr. 12/07/05 at 52-53. Mr. Weiss also agreed that neither Cox nor wireless carriers need to obtain facilities from Verizon RI in order to provide service to much, if not all, of the state. *Id.* at 53. Thus, Verizon RI no longer controls the "last mile" of access. The Division then is left with no theoretical or rational support for its proposal to continue to impose asymmetric price regulation on Verizon RI and the residential local exchange market.

Second, Mr. Weiss admitted that he had submitted no data showing the number of people included in the pocket of the market that is the object of his concern, and that he has offered no economic analysis showing how various potential rate increases would or would not affect these consumers. Tr. 12/07/05 at 54-55, 78, 79. Thus, the Division made no showing of the size of the pocket of consumers who allegedly neither want nor can afford any alternatives to Verizon RI's services. The Commission should not impose regulatory restrictions on all of Verizon RI's residential rates out of a subjective concern for a small subset of the market of unknown size and unknown economic circumstances.

Moreover, the evidence before the Commission demonstrates that competition in the market protects all residential consumers from unreasonable price increases – even those few consumers for whom alternative technologies and providers may not be available or economical. In other words, all of Verizon RI's residential rates are disciplined by Cox's prices for landline basic exchange service, wireless services and VoIP service, even if those products are not

available to all customers. Cox, for example, offers its unlimited basic service for \$19.95 a month throughout the state, Lafferty Surrebuttal at 14, and for only \$11.95 a month for those customers who also purchase CATV from Cox, who comprise fully 70 percent of all residential customers of electric service in the state. Tr. 12/06/05 at 162-164. Cox's \$11.95 rate is measurably lower than Verizon RI's rates for unlimited basic service. *See* Commission Ex. 1, Verizon RI Response to PUC Data Request 1-8(c). In response to questioning by the Commission's Executive Counsel, Mr. Vasington explained that Cox's \$11.95 rate constrains Verizon RI's prices for unlimited basic service even for those customers who do not have access to Cox's CATV service:

MR. FRIAS: For the 30 percent of the population that basically doesn't have Cox cable for whatever reason, okay, there's actually two towns where you can't get it, Foster and Block Island you probably heard this morning, they want phone service from Cox, it's going to be \$19.95.

MR. VASINGTON: Correct.

MR. FRIAS: Why do you see that as a competitive market because that price will be higher than what a similar service will be from Verizon?

MR. VASINGTON: Because we don't know who they are. 70 percent of the people do have access to the \$11.95 from [Cox], some people don't have access and they only have access to the \$19.95. We can't -- we don't know and we're not good enough to go out there and perfectly discriminate on the basis of who has options and who doesn't, we don't know that information, so we can't go out there with a price and say, "All right. Well, we're going to figure out which customers have taken cable and which ones haven't and we're only going to offer this low price to the customers who have taken cable, but we're going to have the other price for people who don't have cable.[""] We're not good enough to do that and I don't think anybody is in the marketplace so that the Commission can take confidence that because so many people have access to this option and we have no way of knowing who they are that we are unable to price in such a way as to offer a better price to the customers who have the option versus the people who don't. So in effect what happens is the people who don't have as many options end up getting protection from the people who do have the option.

MR. FRIAS: So that's only true, however, as long as you do not geographically deaverage to the point where you can split apart customers based on who's a Cox cable customer versus who isn't a Cox cable customer, correct?

MR. VASINGTON: That's probably true everywhere else but Rhode Island. It's my understanding that [there is] a very small portion of the state where the question of not having access to cable at all is an issue. It may be a bigger issue in Maine.

MR. FRIAS: Let's use Newport. Let's say [Verizon's basic exchange rate is] around 14. You'd be concerned about raising your rate to, let's say, \$19.94 because there's a possibility you would lose a lot of customers going to the 11.95 rate and you can't differentiate between those who have cable telephone -- excuse me -- cable access from Cox versus those who can.

MR. VASINGTON: Yeah. I'm a little reluctant to use specific numbers and say that would be a price we'd be worried about, but it's a toll on our ability to price in a way that would be not competitive.

Tr. 12/06/05 at 166-169. The Division's expert, Mr. Weiss, agreed with Mr. Vasington as to the disciplinary effect of Cox's \$11.95 rate, as follows:

Q: I asked the question of Mr. Vasington about the price discipline -- about the problem having 70 percent of the state having actual cable from Cox while the other 30 percent does not have cable from Cox, and I expressed what about that other 30 percent essentially.

A: (Nodded affirmatively).

Q: And he said this -- I'm going to paraphrase. The answer is that there is adequate price discipline on Verizon in that scenario because they cannot distinguish between a cable -- a telephone customer who has cable versus who does not have cable. ... Do you find that there is sufficient price discipline under that scenario?

A. Well, certainly without the knowledge Verizon has to be disciplined under that scenario. They can't possibly make a decision without that knowledge.

Tr. 12/07/05 at 64-65. Thus, because Verizon RI cannot discern between the large number of its customers who take cable television from Cox (and may therefore switch to Cox's \$11.95 rate plan) and the smaller number of those who do not, that rate plan constrains Verizon RI's rates for all of its residential customers.

Verizon RI's rates for unlimited basic exchange service are further constrained by Cox's \$19.95 rate for unlimited basic service for customers who do not buy CATV from Cox, as well as by wireless and VoIP packages. Although nominally higher than Verizon RI's rates for unlimited local service, Cox's \$19.95 rate includes the additional feature of call forwarding. Adding Verizon RI's tariffed rate for this additional feature to its basic exchange rates raises most of its combined prices up to or beyond Cox's rate. *See e.g.* Commission Ex. 1, Verizon RI Response to PUC 1-8(a) (showing Verizon RI's rate centers for unlimited residential basic exchange service). Not all customers will want the call forwarding feature built into Cox's rate, but because Verizon RI does not know which of its customers might want it and therefore find Cox's plan to be an appealing substitute for Verizon RI's services, Verizon RI must react to the competitive threat posed by Cox's \$19.95 rate and price its own services accordingly.

By the same token, while few wireless providers offer service at rates on par with Verizon RI's unlimited basic exchange service, wireless service comes with the inherent and significant value associated with mobility and almost always includes additional features, such as voicemail and free intrastate and interstate long distance calling. Because Verizon RI is unable to sort out which of its customers might consider replacing his or her landline with wireless service or with VoIP (and is also unable to distinguish among its customers by age group, Tr. 12/06/05 at 181), it must take account of the additional features included in those services in

setting its own rates. *See e.g.* Tr. 12/06/05 at 150 (VoIP is a “significant price disciplining force” even though it may not be a viable substitute for all landline customers.)

The same reasoning applies to Verizon RI’s rate for measured local exchange service, which at \$8.17 per month (see Verizon RI Response to Data Request Division 1-25) is only nominally lower than Cox’s \$11.95 rate, which includes unlimited local calling and additional features not included in Verizon RI’s measured service rate. Mr. Vasington explained as follows:

Well, I think it [Cox’s \$11.95 rate] would have a significant effect because it’s a price that is comparable to our measured service rate for a service that you receive more than just measured service and it’s available, as we’ve heard already today, to 70 percent of the customers in Rhode Island. So I think it has a significant price disciplining effect.

Tr. 12/06/05 at 237. Mr. Vasington also explained that the rate for measured service is disciplined by the rates charged by Verizon RI and others for unlimited service. Tr. 12/06/05 at 180-181. Certainly, if the rate for measured service were to rise, more measured rate customers (those who make some but not many toll calls) will see unlimited service as a better value and option. The Division may argue that the Commission must impose a cap on Verizon RI’s measured service rates, to ensure the continued availability of basic service at a rate close to \$8 a month. Of course, neither the Division nor any other party has offered any evidence showing that \$8 is a more appropriate rate than some other rate, or that a rate higher than \$9 would not be reasonable. Moreover, Mr. Vasington testified at hearing that even if the Commission were to artificially depress rates in order to advance a social policy, Verizon RI “should not be picked out . . . as the sole provider of social policy obligations that are not shared by others.” Tr. 12/06/05 at 189. The former premise for imposing such asymmetric regulation – market power in a single monopolistic service provider – no longer exists where, as here, the market is fully

competitive. *Id.* Again, because Verizon RI does not have market power, the Commission should regulate its rates in the same way it regulates the rates of all other carriers, by allowing those rates to respond to the market.

For these reasons, the Division's insistence on a \$1 cap on increases in Verizon RI's basic residential rates no longer reflects the reality of robust and widespread competition in the market. The Division acknowledges that reality, but nevertheless recommends that the Commission ignore it and simply continue forward with essentially the same restrictions on Verizon RI's rates that were imposed three years ago, when CLECs controlled less than 15% of the residential land-line market, wireless service was taken by fewer customers and VoIP did not even exist as a commercial alternative. In addition, the Division's \$1 cap is, at root, random. It is derived from a settlement between the Division and Verizon RI three years ago and has no basis in economic theory or in data concerning the market. As Mr. Weiss testified, the Division has offered no economic analysis in support of that particular rate cap, versus a \$2 annual cap or some other amount. Tr. 12/07/05 at 79. The Division's inability to provide a foundation for its cap supports Verizon RI's point that in a fully competitive market such as the local exchange market in Rhode Island, the only rational way to provide for reasonable rates is to allow the market to set them.

3. The Commission's 70% market share threshold for granting pricing flexibility to Verizon RI is not limited to the business market.

The closest the Division comes to contesting the applicability to this case of precedent set in Order No. 17417 is Mr. Weiss' claim that the 70% market share threshold the Commission established in that order might apply to full pricing flexibility in the business market only and that, "the Commission correctly made no such direct finding with respect to residential markets."

Weiss Surrebuttal at 3. Mr. Weiss' attempt to distinguish the two markets and establish a separate standard for each has no merit. In the first place, the Commission's decision in Order No. 17417 does not pertain solely to the business market. While the Commission did apply the 70% guideline to Verizon RI's rates for business services in that order, it also applied the same guideline to Verizon RI's rates for residential service, holding that, "*Due to the more than 70 percent market share of VZ-RI in the Rhode Island residential market*, however, the Commission finds there is a continuing need for price ceilings on VZ-RI's retail residential services." Order No. 17417 at 49 (emphasis added). Thus, the Commission has already applied that standard to the residential market. In addition, the Commission recently re-affirmed that the 70% standard applies to both the business and residential sectors of the local exchange market.⁵

The Division implies that the residential market is different from the business market, but it fails to identify any differences or explain how they require a different standard for the residential market. Nor does the Division suggest what that new standard should be. In light of these failures, the Commission should continue to use the 70% threshold in its evaluation of the competitiveness of the residential market, to the extent that it continues to rely on market share as the determining factor.

4. Neither the FCC's *Triennial Review Order* and *Triennial Review Remand Order* nor the "national scope" of Verizon affords grounds on which to impose caps on Verizon RI's residential rates.

Cox's expert witness, Wayne Lafferty, suggested in his written testimony that the Commission should be concerned about Verizon RI's alleged market power in light of Verizon's "national scope and size" and the FCC's recent *TRO* and *TRRO* decisions eliminating UNE-P as a mode of entry into the market. Lafferty Direct at 22-23. Neither of these arguments is

⁵ See *In re Verizon Rhode Island's Request for Partial Relief from Alternative Regulation Plan*, Docket No. 3445A, Report and Order issued March 28, 2005, Order No. 18198, at 19-20.

supported by the facts. First, Mr. Lafferty fails to explain how Verizon's national operations create market power in Rhode Island. In addition, Mr. Vasington pointed out that contrary to Mr. Lafferty's claim, Verizon faces significant competition from traditional CLECs, cable, wireless and VoIP providers wherever it offers residential service, and that the local exchange market in Rhode Island is more competitive than the standard the cable industry has set for itself. Vasington Rebuttal at 13-14. As for the *TRO* and *TRRO*, Mr. Lafferty fails to appreciate that Verizon RI's largest competitors in the Rhode Island residential market – Cox itself, wireless and VoIP providers – do not rely on UNE-P, so that its elimination is most unlikely to have any effect on this market. Moreover, as Mr. Kenney testified at hearing, most UNE-P CLECs are converting over to commercial agreements and will be utilizing a UNE-P replacement product in Rhode Island. Tr. 12/06/05 at 157.

In sum, none of the concerns raised by other parties with respect to Verizon RI's proposal for full flexibility in setting its rates for residential service has merit. The undisputed evidence before the Commission demonstrates that Verizon RI's share of the residential market is well below the Commission's 70% threshold, that both supply and demand elasticity in the residential market are high and that accordingly, competition in the market is sufficient to discipline Verizon RI's rates and ensure just and reasonable rates without the need for further government intervention. In the absence of market power, Verizon RI should be regulated just like any other telecommunications carrier.

II. The Plan's proposal to gradually reduce Verizon RI's share of the Lifeline subsidy by \$1 a year for two years is just and reasonable.

Verizon RI's Lifeline customers currently receive a subsidy for basic unlimited service of \$9, comprised of \$5.50 from Verizon RI and \$3.50 from the federal government. Lifeline customers taking measured service receive a subsidy of \$7.17, so that they currently pay only \$1 a month for service. O'Brien Direct Testimony at 7-8. As Ms. O'Brien pointed out, Lifeline customers have not seen an increase in the rates they pay in 11 years. *Id.* at 9. Verizon RI has proposed a gradual reduction in the subsidy over two years in order to minimize the effects on its low-income customers. Verizon RI has also intentionally limited the reduction so that Lifeline customers will continue to receive the full federal subsidy of \$3.50. *Id.* In addition, the majority of Verizon RI's Lifeline customers also purchase additional features from Verizon RI. *See* Commission Ex. 1, Verizon RI's Response to PUC 2-2. Thus, the issue here is not whether Lifeline customers will continue to be able to afford basic telephone service but only whether they will be able to purchase call waiting, caller ID and the like. The purpose of the Universal Service provisions of the Act of which the Lifeline program is a part is to ensure universal access to basic telephone service, not access to additional calling features. Mr. Weiss testified to this point:

Q: I think you indicated what [the universal service concept] was, but it was essentially the ability to have phone service regardless of where you are or your income level. Is that essentially – am I paraphrasing it about right?

A: That's about right, yeah.

Q: But that does not include, for instance, features?

A: That's correct. The Lifeline concept did not include features in the beginning, that's correct.

Tr. 12/07/05 at 70-71. No party has offered any policy reason for expanding the scope of that program now, at the sole expense of Verizon RI.

Moreover, Verizon RI's proposal would only reduce its Lifeline subsidy to a total of \$7, which the Division and Commission have already found to be an appropriate level. Mr. Weiss conceded at hearing that the Division approved Cox's tariffed \$7 subsidy rate for its own Lifeline customers, Tr. 12/07/05 at 55, and he agreed that the Division's position is that a \$7 Lifeline subsidy off of a \$20 basic exchange rate is appropriate at this time. *Id.* at 55-56. The Commission likewise approved Cox's tariff filing and has not required Cox to increase the amount of that subsidy. Accordingly, there can be no argument that, as a matter of social policy, a \$7 Lifeline subsidy is insufficient or less than fair.⁶

The Division does not object to the systematic reduction in the Lifeline subsidy proposed by Verizon RI but asks the Commission to delay implementation of Verizon RI's proposal for one year, to allow the General Assembly time to consider legislation on the subject. Weiss Direct Testimony at 12-13. Once again, however, the Division fails to appreciate that the Rhode Island residential market is fully competitive, and that a one year delay in equalizing the levels of Lifeline subsidies leaves Verizon RI at a distinct competitive disadvantage, certainly vis-à-vis Cox. The level of a customer's Lifeline subsidy should not depend on whether service is provided by Verizon RI or by Cox, and there is no policy basis for continuing to require Verizon RI alone to provide a Lifeline subsidy higher than is legally required – even for a year. The Commission needs no additional authority from the legislature in order to eliminate this archaic inequality.

⁶ While Verizon RI's proposal would even out the subsidy at \$7 for all Lifeline customers, this will result in just a \$0.17 increase for measured service customers. While Lifeline rates would then be allowed to respond to changes in Verizon RI's other rates, the total monthly charge of \$1.17 for Lifeline measured service customers is so low as an absolute value, there should be no concern that reasonable fluctuations in market rates could price this service beyond the means of Lifeline customers.

- III. The Commission should approve the terms of the Plan eliminating the requirements that Verizon RI file with the commission detailed annual financial statements, semi-annual competitive profile reports and monthly service quality reports.

The continued expansion of competition in the Rhode Island local exchange market makes obsolete the Commission's current policy of requiring Verizon RI, and Verizon RI alone, to file a detailed and public annual financial statement, competitive profiles and service quality reports. These reports are no longer necessary, and they impose an unfair and undue burden on Verizon RI not borne by any other competitor in the state.

Verizon RI's annual financial statement to the Commission, for example, includes detailed itemizations of Verizon RI's revenues (both intrastate and on a combined basis) and expenses to arrive at net earnings, a calculation of debt and equity, a calculation of return on equity and a report of Verizon RI's access lines in service. Tr. 12/06/05 at 97. This detailed financial statement is available to the public, including Verizon RI's competitors. *Id.* at 88. No other competitor in Rhode Island is required to disclose such detailed financial information. O'Brien Direct Testimony at 11. Indeed, there was comment at hearing that other telecom carriers report to the Division only their annual revenues and number of access lines. Tr. 12/07/05 at 60-61. The Division does not make competitors' information public. Thus, not only is Verizon RI saddled with the burden of preparing a financial statement not imposed on its competitors, but those competitors are allowed all the competitive advantages that come from detailed knowledge of Verizon RI's performance from year to year, while Verizon RI is kept in the dark as to its competitors' performances.

The semi-annual competitive profile and the monthly service quality reports likewise impose unfair and unwarranted burdens on Verizon RI alone. In response to questioning from

the Attorney General's Office at hearing, Ms. O'Brien testified that the service quality reports are not automated and cannot be produced at the click of computer keyboard button, but rather require Verizon RI to extract the relevant data from a number of sources within the company to be compiled into the reports. Tr. 12/06/05 at 131. The Division too recognized the burden of preparing the monthly service quality reports, though it recommended only that the frequency of the reports be reduced to quarterly. Weiss Direct Testimony at 15. No party disputed that, whatever the burden these reports impose on Verizon RI, it is not shared by any other carrier.

The Division contends that the Commission "maintains its legislative mandate to continue monitoring the Company's operations and its financial condition." Weiss Direct Testimony at 15. But that mandate applies to all carriers in the state, not just Verizon RI. Given that Verizon RI does not have market power in the state, the Division is at a loss to explain why the Commission should continue to impose these reporting requirements on Verizon RI alone. The continued disparate treatment of Verizon RI is inconsistent with the goal of fair competition in the market.

In any event, these reports are no longer necessary given the competitiveness of the market and the other sources of data available to the Commission. The Division suggested at hearing that the Commission needs to continue to receive Verizon RI's annual financial statement as an indirect method of monitoring the health of the market, Tr. 12/06/05 at 88-89, but the Commission can do that without nearly the level of detail and complexity included in those reports today. A simple annual report of revenues and access lines similar to what CLECs report to the Division today would serve that purpose equally well. Also, the Company files detailed information about its financial performance with the FCC as part of the FCC's

Automated Reporting Management Information System ("ARMIS"), and that information is readily available to the Commission.

In addition, the Division agreed at hearing that it would compile the revenue and access line data it receives from carriers into an annual profile for the Commission's use, thereby obviating the need for Verizon RI to file its own profiles in the future. Tr. 12/07/05 at 61-62. Because the Division's access line counts come directly from the carriers, its profiles would be more detailed than the aggregate numbers in Verizon RI's current competitive profile. In addition, the FCC's annual *Local Telephone Competition*: Status reports (see e.g. Kenney Direct Testimony at 4, n. 2.) reports the number of ILEC and CLEC access lines in the Rhode Island local exchange market and is therefore another source of data, one on which the Commission has relied in the past. See Order No. 17417, at 47.

The competitiveness of the local exchange market also removes any ground for continuing to require Verizon RI to prepare and file service quality reports. Just as competition is sufficient to discipline Verizon RI's rates, it is also sufficient to discipline its service quality. Verizon RI is fully aware that if its customers become unhappy with the quality of Verizon RI's service, they can easily vote with their feet and take their business elsewhere. See O'Brien Direct Testimony, at 10. The Division asserts that Verizon RI's retail service quality reports "form a base that the Commission uses to assess" Verizon RI's wholesale service quality. Weiss Direct Testimony at 15. This is simply incorrect. As the Attorney General's Office made clear at hearing, Verizon RI's wholesale monthly Performance Assurance Plan and Carrier to Carrier reports themselves include measurements showing Verizon RI's retail performance on all metrics from which relative wholesale performance is measured. See Tr. 12/06/05 at 133-136; Attorney General Ex. 2, at 5-6.

Finally, the Commission should bear in mind that while the Plan would eliminate these particular, asymmetric reporting requirements, nothing in the Plan affects the Commission's authority to reasonably request and obtain information, including financial performance data and service quality data, from Verizon RI when and if the need arises. Given this overall authority, the Commission should not hesitate to release Verizon RI from the unfair and unnecessary reporting requirements discussed above.

- IV. The Commission should reject Cox's proposals to insert into the Plan additional, unnecessary restrictions on Verizon RI that would not apply to any other carrier, including Cox.

The Commission should reject the various proposals from Cox to add new terms to the Plan, not present in the current or any past Plan, with respect to promotions, geographic de-averaging and the filing of cost studies with the Division. Cox's proposals lack merit for a number of reasons. They are not intended to benefit or protect Rhode Island consumers but are aimed at gaining an unfair competitive advantage through more burdensome regulation of Verizon RI.

For example, Cox seeks to impose a price floor on Verizon RI's promotions, but Cox has made no showing that such a restriction is warranted. There has been no showing that Verizon RI's promotions have had any anti-competitive effect. To the contrary, Ms. O'Brien testified that promotions benefit consumers, Rebuttal Testimony at 8, and Mr. Vasington explained that a strategy to lose money on purpose for an extended period of time would only make sense as part of a predatory pricing policy, which is not available to Verizon for many reasons, including its lack of market power. *See* Vasington Rebuttal Testimony at 7. Cox asks that the Commission's 6-month limit on the duration of Verizon's promotions be written into the Plan, but Cox had

offered no evidence that Verizon RI has ever violated that limit as currently enshrined in a Commission order.

In addition, Cox itself has offered promotions at less than its cost. *See* Vasington Rebuttal Testimony at 6. Indeed, Cox is even now running a promotion offering free installation for residential telephone service that could result in it failing to recover its costs where a customer cancel service soon after obtaining it. *See* Verizon RI Ex. 7; Tr. 12/07/05. Cox fails to explain why Cox and all other carriers should be allowed to offer such promotions but Verizon RI should not. Again, in the absence of market power, Verizon RI should not be subject to such asymmetric regulation.

The same failings render Cox's other proposals similarly groundless. Cox asks the Commission add to the plan Cox's paraphrase of the anti-discrimination provisions of R.I.G.L. Section 39-2-2, on the alleged grounds that it merely restates the statute and therefore should not be objectionable. Lafferty Rebuttal Testimony at 12. The statute, however, applies to all carriers in the state, including Cox, and Cox has failed to offer any factual basis for imposing a special regulatory restatement of the statute on Verizon RI alone – perhaps by a showing that Verizon RI has violated or circumvented the terms of the statute or the Commission's policy regarding geographic rate de-averaging. In any event, the tariff filing and review procedure affords the Commission full opportunity to investigate any future rate change that might raise concerns as to rate de-averaging, without the need for a special term in the Plan.

Finally, Cox asks the Commission to revise the Plan to authorize Verizon RI's competitors to "request" that the Division ask Verizon RI to file a cost study in support of its certification that rates for a new product or reduced rates for current products meet the

Commission's price floor test. Lafferty Rebuttal Testimony at 15.⁷ Of course, CLECs currently have the ability to make such a request of the Division, and there is no need to insert such a term into the Plan. Moreover, Cox conceded that Cox itself is not even subject to the price floor requirement that applies to Verizon RI, and it has offered no basis for imposing a special regulation on Verizon RI alone. Certainly, Cox has offered no facts showing that Verizon RI has ever violated the price floor or has been unable to provide the appropriate cost study when requested by the Division. On this showing, the Commission must reject Cox's self-serving, unfair and unnecessary proposal.

CONCLUSION

Three years ago, the Commission expressed its hope that:

in time, the need for price ceilings and price floors will diminish as the competitive local telephone exchange market fully develops. . . . [A]t some point, this Commission would only "intervene and interfere" with the natural workings of the competitive market only cautiously and with great circumspection.

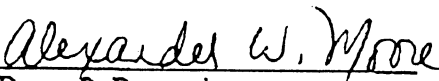
Order No. 17417, at 59-60. That time has come. Consistent with the analytic framework established for evaluating the competitive strength of the market, Verizon RI has demonstrated that competition in the Rhode Island residential local exchange market is now sufficient to discipline Verizon RI's prices and constrain the company from profitably charging rates above competitive levels for a sustained period of time. Because Verizon RI no longer has market power, there is no longer any rational basis for continuing to impose price ceilings on its residential rates or otherwise regulating its operations any differently than other carriers are regulated. As noted above, Rhode Island boasts the single most competitive telecommunications

⁷ Cox's actual re-wording of the Plan would in fact give CLECs the *absolute right to require* Verizon RI to file such a cost study. See Lafferty Direct Testimony at 20. Cox insists that its proposal is only meant to allow CLECs the right to "request" such a filing, however, see Lafferty Surrebuttal Testimony at 15, and Verizon RI therefore assumes that Cox has retreated from its original position.

local exchange market of any state in the nation, and it is time to match that level of competition with a nation-leading effort to update regulatory oversight, as this Plan would do. Accordingly, the Commission should approve the Successor Alternative Regulation Plan as submitted by Verizon RI.

VERIZON RHODE ISLAND

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